STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
OFFICE OF THE HEALTH INSURANCE COMMISSIONER
1511 PONTIAC AVENUE
CRANSTON, RHODE ISLAND 02920

IN THE MATTER OF:	
BLUE CROSS & BLUE SHIELD SUBSCRIPTION RATES FOR CLASS DIR	**OHIC No. 2009-1**
Filed November 21, 2008	

DECISION

I. INTRODUCTION

The above-entitled matter came before the Health Insurance Commissioner ("Commissioner") with the filing of a request for increase of rates for Class DIR (also known as "Direct Pay") by Blue Cross & Blue Shield of Rhode Island ("Blue Cross") on November 21, 2008. The Filing requested approval of an average increase of 6.8% for Pool I members and 4.3% for Pool II members. The rates are proposed to be effective for policies renewing after April 1, 2009.

An order appointing Samuel D. Zurier, Esq. and Charles C. DeWeese, FSA, MAAA as hearing officers was issued on December 2, 2008. On December 4, 2008 Mr. Zurier issued an Order requiring that the parties attend a prehearing conference on December 9, 2008. The prehearing conference was held and an order issued by Mr. Zurier on December 12, 2008 scheduling hearing dates of January 14 and 15, 2009 for public comment and January 22, 2009 for testimony and submission of evidence. At this prehearing conference

and throughout the proceedings, Blue Cross was represented by Norman Benoit, Esq. and the Attorney General was represented by Genevieve Martin, Esq. and Suzette Pintard, Esq.

On December 8, 2008, Blue Cross and the Attorney General filed a joint motion to disqualify Mr. Charles DeWeese as a hearing officer. On December 24, 2008 the Commissioner issued an order denying the joint motion to disqualify Mr. DeWeese. Blue Cross and the Attorney General petitioned the Superior Court for a Temporary Restraining Order to prevent Mr. DeWeese from serving as a hearing officer. The Superior Court granted the Temporary Restraining Order. Both parties advocated that R.I. Gen. Laws §§ 27-19-6 and 27-20-6 required that the hearing officer be a member of the Bar and be prevented from engaging in any *ex parte* communications. In essence, the position is that the recommendation be based solely on legal analysis rather than actuarial analysis.[1]

On January 2, 2009 notice of the filing and hearing dates was published in the Providence Journal. Notice was also sent to subscribers in accordance with R.I. Gen. Laws § 27-19-6(a). (Blue Cross Exhibit 10.)

On January 13, 2009 the Commissioner issued an order providing that Mr. DeWeese would no longer serve as a hearing officer in this matter. On January 14 and 15, 2009 the hearing was opened and public comment was taken. On January 16, 2009 the

[1] The parties "suggested" that the OHIC could hire an actuary to ask questions at the hearing but that individual could not consult with the hearing officer on the Decision. This suggestion would not provide actuarial analysis to the decision on rates, rather it would simply add a third testifying actuary to the hearing. The analysis of all of that testimony and documents submitted into evidence would still be done solely by an attorney. Notwithstanding this "suggestion", when the hearing officer indicated that this would be done the parties "objected." In their post hearing brief Blue Cross goes to great lengths to "explain" this objection which was clearly inconsistent with its prior position. In essence, Blue Cross states that they were "concerned" with issues that they chose not to share with the hearing officer (the response to the inquiry simply states "we do not agree to waive any such cross-examination.") Blue Cross then claims that the hearing officer "was not familiar with the details of the travel of the case of the Superior Court litigation..." This statement is not true and is not based on any evidence in the record.

Commissioner issued an order substituting Elizabeth Kelleher Dwyer, Esq. for Samuel Zuirer, Esq. as hearing officer. On January 20, 2009 a status conference was held with the substitute hearing officer and the parties. At that time Items 9 and 10 of the December 9, 2008 Order were vacated.

On January 22, 2009 the hearing resumed. At that time additional public comment was taken and evidence was presented by Blue Cross and the Attorney General. Blue Cross submitted into evidence fourteen exhibits identified on their exhibit list. The Attorney General submitted eighteen exhibits that were identified on their exhibit list. One set of documents was admitted into evidence as OHIC exhibit 1. All of these exhibits were admitted as full exhibits without objection. Both Blue Cross and the Attorney General submitted closing briefs on February 10, 2009.

II.
JURISDICTION

The Office of the Health Insurance Commissioner (OHIC) has jurisdiction in this matter pursuant to R.I. Gen. Laws §§ 27-18.5-1 *et seq.*, 27-19-6, 27-20-6, 42-14.5-3(d) and 42-14-5(d). The hearing was conducted in accordance with the provisions of the Administrative Procedures Act, R.I. Gen. Laws §§ 42-35-1 *et seq.*

III.
STANDARD OF REVIEW

The rates requested by Blue Cross must be "consistent with the proper conduct of the applicant's business and with the interest of the public . . . ." R.I. Gen. Laws §§ 27-19-6 and 27-20-6. In 2004 the Rhode Island General Assembly established the meaning of "proper conduct of the applicant's business" with the enactment of R.I. Gen. Laws § 27-19.2-1 *et seq.* See *In re Blue Cross & Blue Shield of Rhode Island Petition for*

Increase of Rates for Class DIR, DBR No. 04-I-0144 (Nov. 23, 2004), aff'd, *Blue Cross & Blue Shield of R.I. v. McConaghy*, 2005 R.I. Super. LEXIS 107 (R.I. Super. 2005). They decreed that Blue Cross' mission includes providing "affordable and accessible health insurance to insureds" and "affordable and accessible health insurance to a comprehensive range of consumers, including business owners, employees and unemployed individuals." R.I. Gen. Laws § 27-19.2-3 Blue Cross must also "employ pricing strategies that enhance the affordability of health care coverage . . . ." These legislative directives make clear that the "proper conduct of the applicant's business" is not left solely to the management's discretion unless that discretion is exercised to provide "affordable" and "accessible" health insurance. R.I. Gen. Laws § 27-19.2-10(3).

The Commissioner may approve, disapprove, or modify the rates proposed by Blue Cross. R.I. Gen. Laws §§ 27-19-6 and 27-20-6.

IV.
MATERIAL FACTS AND TESTIMONY

Public Comment

On January 14, 2009 Edward Gaul, a Direct Pay subscriber for the last eight years, testified that Blue Cross' rates are unaffordable and that the company needs to be held accountable to their past and present operating expenses.

Paul Rollins testified that it is outlandish to ask for an increase in these economic times and Blue Cross should be prohibited from doing so until they cut every possible administrative expense. His family plan is his most expensive monthly bill and is approaching $1,000 a month.

On January 15, 2009 Anna DeMoranville testified that she has been a Direct Pay subscriber for five years and a subscriber of other types of Blue Cross plans for the previous

25 years. This year she incurred costs well in excess of her $3,000 deductible but Blue Cross was not paying the bills. As a result of Blue Cross failing to pay she has in excess of $4,000 in medical costs on various credit cards and has only been reimbursed approximately $300. She believes that Blue Cross can save money, and therefore not be required to raise rates, by streamlining its claims process. She believes that its inefficient management is to blame for increased costs and premium increases should be denied.

Alexander Jacques testified that he is 26 years old and has a chronic medical condition. He is currently unemployed and was on his father's COBRA plan until recently when he signed up for a Direct Pay product. The COBRA plan, which was issued by a Blue Cross of another state, was less expensive than his current direct pay premium. The plan he is currently on has a $3,000 deductible and costs $423 per month. Although he received a financial credit from Blue Cross he is still paying, out of pocket, $343 each month. Because of his chronic medical condition he estimates that he will spend $9,000 on healthcare and health insurance premiums this year. He does not understand how Blue Cross can need more premium from an individual in his situation who is barely getting by. He believes that Blue Cross should cut back on frivolous expenses and not get a rate increase from Direct Pay subscribers.

On January 22, 2009 George Goodwin testified that Blue Cross has not taken into account the extreme difficulties Direct Pay customers face. In the last five years his premiums have increased from $544 to $732 a month or 32.7%. Healthcare was the second highest family expense last year representing 14% of his income. With the current economic climate Blue Cross' request should be denied.

Daniel How testified that Direct Pay premiums are not affordable and are greatly in excess of the inflation rates.

In addition to those person who were able to attend the hearings, OHIC received written comment from two individuals. Lois Vaughan Eberhard wrote that she is a self employed individual who has problems affording the increasing premiums. She indicated that the rate increases over the last few years, coupled with reductions in coverage "are crippling."

Valerie Tutson wrote the she is a Direct Pay customer and a small business owner. She indicates that the current premiums and coverages are unaffordable.

No public comment was received supporting the rate requested.

Hearing Testimony

John Lynch, FSA, MAAA

On January 22, 2009, Blue Cross presented the testimony of John Lynch, FSA, MAAA who testified as to how the requested rate increase was calculated. Mr. Lynch was accepted as an actuarial expert. With regard to "affordability" Mr. Lynch referred to the new plan designs implemented in 2005 and to "AccessBlue" which helps low income subscribers "...absorb some of the escalating costs of health insurance premiums."[2] (Blue Cross Exhibit 4, page 9.) Mr. Lynch testified that he or someone under his supervision developed the requested rates and that the "...rate calculations and the actuarial assumptions and methodology underlying these required rates are actuarially sound" (Blue Cross Exhibit

[2] Blue Cross' position is that AccessBlue "...does not constitute any part of the requested rates in this Filing." (Blue Cross post-hearing memorandum, page 9.) The reason for this "legal" argument is not clear to the hearing officer and, therefore, the hearing officer makes no determination as to its validity. However, pursuant to Blue Cross' statement that AccessBlue is not part of the requested rates, the hearing officer will not consider AccessBlue when evaluating whether the Direct Pay rates meet the "affordability" criteria.

4, page 16.) Mr. Lynch further testified that Blue Cross continues to take the position that "...Direct Pay should recover not only its claims and administrative expenses, but it should contribute its fair share toward corporate reserves." (Blue Cross Exhibit 4, page 18.)

Mr. Lynch's prefiled testimony went through each of his calculations, the changes that had occurred in enrollment in the prior year, the differences between the two Pools and the experience adjustments that Blue Cross had undertaken. Mr. Lynch also discussed Blue Cross' current and target reserve levels. While he testified that Class DIR has "...a projected negative reserve balance" (Blue Cross Exhibit 4, page 59) the hearing officer notes that this is an internal Blue Cross calculation and that the OHIC does not acknowledge a "negative reserve balance" especially since Blue Cross' request to contribute to reserves for this class has been specifically denied.

On cross examination the Attorney General inquired into the process of assignment to Pool I and Pool II and the process for evaluating those assignments when challenged (Transcript of January 22, 2009, pages 14 to 17), clarification that only a single subsidy is available per policy under AccessBlue (Transcript of January 22, 2009, pages 18 to 20) and specifics regarding charitable contributions (Transcript of January 22, 2009, page 21 to 22). Mr. Lynch confirmed that notwithstanding his statements as to the "negative reserve position" of this class, since April 1, 2006 the Direct Pay class position has improved by $4.5 million and he does not expect current subscribers to "make up" for losses incurred prior to April 1, 2006. (Transcript of January 22, 2009, page 82). Mr. Lynch confirmed that Blue Cross is ranked 21st out of 36 plans by the Blue Cross Association based upon Risk Based Capitol ("RBC"). He knows of only one state which has established a

"maximum" RBC and he does not believe that any plan in the country exceeds that "maximum." (Transcript of January 22, 2009, pages 82 to 88)

It is Blue Cross' position that Direct Pay should continue to bear a share of unallocated costs in relation to its premium notwithstanding the fact that it is the only line where the subscriber pays premium directly. (Transcript of January 22, 2009, pages 23 to 24). Mr. Lynch confirmed that AccessBlue was income based and that the "affordability' for those who exceeded that income limit was addressed in the "Affordability Report" and in plan design. (Transcript of January 22, 2009, pages 24 to 27) Beginning last year Blue Cross included state assessments (e.g. childhood immunization) in Direct Pay rates and these assessments added one percent to the premium. (Transcript of January 22, 2009, pages 33 to 35). Mr. Lynch also confirmed that, notwithstanding the OHIC's reduction in the requested increase, last years' increase resulted in greater earnings than anticipated. (Transcript of January 22, 2009, page 35 to 37). The filing contained projections of increased administrative costs next year but did not know who made the decision to increase these costs. (Transcript of January 22, 2009, page 37 to 38)

In response to further questioning from the hearing officer, Mr. Lynch testified that he disagreed with the two issues raised by the Attorney General's actuary in prefiled testimony. On the first issue, he believes that all classes, including Direct Pay, should contribute to reserves. (Transcript of January 22, 2009, page 88).

On the second issue, he testified that that "Pool shifting" is included in his trend calculation and that the Attorney General's actuary has failed to take into account the decreased income from the healthier subscribers. (Transcript of January 22, 2009, page 90 to 98). He noted that his 8.3% trend compared favorably with the group trends approved by

the OHIC for both United and Blue Cross which were over 9%. (Transcript of January 22, 2009, page 98). In his opinion the reasons that earnings last year were higher than anticipated were members' utilization of services with the cost sharing plans and that the movement between plans was higher than expected. (Transcript of January 22, 2009, pages 100 to 102). Mr. Lynch indicated that the rate filing is prepared under his supervision and that it is his position that yearly filings should be made to guard against "rate shock" (Transcript of January 22, 2009, pages 104 to 105)

In responses to further questioning from the Attorney General, Mr. Lynch admitted that in response to a data request marked as Blue Cross exhibit 14, he did not discuss consideration of the Pool shifting as an element he took into consideration in developing his trend. (Transcript of January 22, 2009, pages 105 to 106)

In response to redirect by Blue Cross, Mr. Lynch testified that Blue Cross' reserves were at 23% which is on the lower end of the range recommended in the Lewin report. (Transcript of January 22, 2009, page 107) He also confirmed that the trend approved for Direct Pay in 2006 was 10.4%, in 2007 was 9.23% and in 2008 was 8.75%. The trend requested in 2009 is lower than the average of other companies and lower than the trends in the group market which have been approved by the OHIC. (Transcript of January 22, 2009, page 108 to 110) Mr. Lynch testified that the benefit richness factors which had been incorrect in the prior filing have been corrected in this filing. (Transcript of January 22, 2009, page 111). Mr. Lynch tested his opinion on trend by separately considering the last six months. Isolating the last six months showed an increase approximately 10% higher than the requested rate. (Transcript of January 22, 2009, page 112).

Mr. Lynch testified that he disagreed with the Attorney General's actuary and that he believed that her calculations do not take into account the lower premium which Blue Cross would receive with "Pool shifting." (Transcript of January 22, 2009, pages 207 to 209) Mr. Lynch also testified that Direct Pay is approximately 4% of Blue Cross' total insured premium (excluding income from AFA accounts). (Transcript of January 22, 2009, page 210)

Augustine Manocchia, M.D

Blue Cross also prefiled testimony of Augustine Manocchia, M.D. (Blue Cross Exhibit 8). Dr. Manocchia testified that he and his staff work with the actuarial staff to review data and develop processes and initiatives to attempt to mitigate those trends. Dr. Manocchia also testified regarding the existing ongoing Health Management programs.

Dr. Manocchia was questioned by the Attorney General concerning the programs in the "Affordability Report" and Blue Cross' efforts to evaluate those programs for cost effectiveness. (Transcript of January 22, 2009, pages 42 to 75; 113 to 151) The Attorney General did not request that the hearing officer make any specific orders as a result of this testimony other than to suggest that Blue Cross have more "accountability," "transparency" and "monitoring" in place with regard to these programs. (Transcript of January 22, 2009, page 141)

Barbara Niehus, FSA, MAAA.

The Attorney General prefiled testimony of Barbara Niehus, FSA, MAAA. Ms. Niehus was accepted as an actuarial expert. Ms. Niehus testified that it was her opinion that no rate increase was required. This opinion was based on two components. First, Blue Cross had included a provision for contribution to reserves and in her opinion Direct Pay

subscribers should not be allocated any contribution to reserves. This is because of the special vulnerabilities of the Direct Pay class as set forth fully in the order of the Commissioner in last year's Direct Pay rate case. She also looked at the fact that, notwithstanding that order, even taking into consideration the reduction ordered by the Commissioner to Blue Cross' request last year, the actual experience of the class was better than expected leaving 3.25% (before federal income tax) actually available for a contribution to reserves for last year.

Second, Blue Cross applied trend factors which she believes are too high by approximately 4.5%. Her analysis is that Blue Cross has not accounted for the large influx in healthy lives which has been experienced in the last three years. This "Pool mix" should be taken into account to reduce the requested trend factors.

Ms. Niehus' prefiled testimony indicated that when these two factors are corrected to her recommendation, the result is that no rate increase is necessary for the Direct Pay line.

The Attorney General presented a number of suggestions to Blue Cross as to how it could better manage its "affordability" programs, however, it did not ask that the hearing officer make any order relating to the rates as a result of those suggestions. The testimony is before the Health Insurance Commissioner for consideration in his evaluation of these issues as they relate to Blue Cross, however, the hearing officer will not be making any recommendations with regard to this testimony in this Decision.

On cross-examination Ms. Niehus indicated that she agrees with Blue Cross' decision to spread the cost of the Core system over 15 years. (Transcript of January 22, 2009, page 171) She agreed that Blue Cross is "on the lower end" of the Lewin

recommendations, although they are above the minimum. (Transcript of January 22, 2009, page 172) She indicated that some portion of the Direct Pay class would receive beneficial tax treatment if they were self employed or used an HSA funded account. (Transcript of January 22, 2009, page 175) In her recommendation she did take into account the effect of the increase in premium tax scheduled for January 1, 2009. (Transcript of January 22, 2009, page 176) She generally agrees with the proposition that increases should be requested annually to prevent rate shock and states that if a rate increase were necessary at this time she would be making that recommendation. (Transcript of January 22, 2009, page 178) She was aware that her recommended trend factor for Direct Pay is lower than for either small or large group and this would be unusual in the "normal" situation.

On redirect by the Attorney General Ms. Niehus clarified that while it would be unusual to see a lower trend in individual business versus group business, what has been seen by the Blue Cross Direct Pay group over the last few years is far from "usual." (Transcript of January 22, 2009, pages 198 to 199) She notes in exhibit 3 that the trend used for pricing was about 10% in 2006 and about 9% in 2007 but in both years the actual results were about zero. (Transcript of January 22, 2009, pages 180 to 181) She believes that her calculations reflect the lower premium which will be received from the Pool II subscribers. (Transcript of January 22, 2009, page 183) She believes that the AccessBlue program is an excellent program and has been part of the reason that healthy lives have been attracted to Direct Pay. (Transcript of January 22, 2009, page 191) She agrees that, of the 14% administrative expenses filed by Blue Cross (which include contribution to reserves) approximately 4.5% are "variable" meaning that the expense would increase or decrease in accordance with claim volume. (Transcript of January 22, 2009, pages 214 to 215)

On examination by the hearing officer she stated that she believes a number of things are occurring to make the results better than estimated in prior years. Among these are the fact that there is a subsidy going from Pool II to Pool I and utilization is being positively impacted by an influx of healthy Pool II subscribers. Based on the proposed rate changes estimated loss ratio would be 100% for Pool I and 57% for Pool II. (Transcript of January 22, 2009, pages 194 to 196)

David Fogerty

The Attorney General requested that Blue Cross provide a witness to testify concerning the Core System. David Fogerty of Blue Cross was produced and was examined by the Attorney General regarding the Core system. Mr. Fogerty testified that Blue Cross has built the cost of this system into rates beginning in 2008 and spread that cost over the systems' 15-year useful life. (Transcript of January 22, 2009, pages 152 to 157). The Attorney General's expert indicated that she agreed with this strategy of spreading the cost over the useful life. (Transcript of January 22, 2009, page 171)

Eligibility

The Commissioner had requested that the parties brief the eligibility criteria for Direct Pay as part of this rate case. Blue Cross set forth their current internal criteria in response to a data request from the Department which was marked as OHIC exhibit 1. Blue Cross described the current status and stated that they do not believe that any changes are warranted. Mr. Lynch testified that changes in eligibility could result in adverse selection. (Transcript of January 22, 2009, page 27 to 33) The Attorney General addressed this issue in their responsive brief.

The hearing officer believes that this is an issue which requires further study and information and, therefore, declines to make a recommendation in this rate decision with regard to the eligibility for Direct Pay.

V.
ANALYSIS

Both Blue Cross and the Attorney General presented testimony from actuaries who appear, by experience and education, to be learned in the area of the actuarial science. Both actuaries presented affable and creditable demeanors although each presented conflicting testimony on the two issues raised by the Attorney General which will determine whether or not a rate increase is warranted.

The first issue is whether or not Direct Pay customers should "contribute" to reserves. As discussed at length in last years' decision, the Direct Pay customer has additional vulnerabilities because most pay the entire premium out of post tax dollars.[3] Group customers, on the other hand, have at least a portion of their premium paid by their employer. In last years' filing the Commissioner disapproved Blue Cross' request for a contribution to reserves on behalf of this class, although the actual earnings were such that there were funds available for such contribution. In this rate petition Blue Cross has not addressed the Commissioners' concerns other than to say that it disagrees and believes that Direct Pay "should" contribute. Direct Pay constitutes 4% of total insured premium for this company. Therefore, excluding this class from contribution to reserves does not pose a solvency issue. Blue Cross has not advocated any position other than a "disagreement" with the Commissioners' position. The hearing officer recommends that

the same order be made as in the last rate case and that a contribution to reserves for direct pay be disapproved.

Second, Blue Cross has requested a trend factor which the Attorney General's actuary believes is too high. Although Blue Cross pointed to higher trends approved for group business and for other companies, no evidence was presented that either the group lines or the other companies have been experiencing the trending that Direct Pay has seen in the last three years.

Blue Cross presented the testimony of an actuary who contends that its requested trend factor is appropriate. The Attorney General presented testimony of an actuary who contends that the request is not appropriate. When deciding which to believe it is appropriate to consider the statutory requirement of "affordability" as dictating a lower premium. In addition, for the past few years Blue Cross' projections have been incorrect and the rates approved (which have always been less than the rates requested) have produced greater earnings than expected. While Blue Cross claims that they have "corrected" for this fact, this is exactly the claim they made in earlier filings that produced greater than expected earnings. Direct Pay is 4% of insured premium and, therefore, even if the Blue Cross calculations turn out to be correct the slightly understated premiums will not cause a solvency issue. Without the ability to consult with an independent actuary these are the facts upon which the hearing officer must rely in making her decision. Under these circumstances, therefore, the hearing officer is

[3] Blue Cross pointed out that some subscribers would receive favorable tax treatment if they were self employed or if they utilized an HSA account. There was no testimony regarding how many Direct Pay customers would fall into this category.

persuaded to accept the opinion of the Attorney General's actuary and recommend that the trend factor be adjusted.

Blue Cross' actuary was asked why it chose to make a rate filing this year. He responded that he believes that taking smaller annual increases is preferential to waiting a few years and taking a larger increase. This is because of the effect of the larger increase on consumers which is commonly referred to as "rate shock." The hearing officer agrees that insurers, including Blue Cross, should not put off necessary rate increases for multiple years. However, this fact does not address the issue of whether a rate increase is necessary. Although the vulnerability of the Direct Pay population has been identified as being significantly different than the employer based population by both the Department of Business Regulation and the Health Insurance Commissioner, Blue Cross continues to refuse to acknowledge this fact and continues to insist that no special consideration should be made in the development of rates for Direct Pay customers. Although Direct Pay constitutes approximately 4% of Blue Cross' premium volume, Blue Cross continues to insist that Direct Pay "contribute" to reserves. The Commissioner has previously rejected that request, however, Blue Cross continues to argue that there is a "deficiency" in reserves in an "account" tied solely to Direct Pay. Blue Cross needs to carefully consider these issues prior to filing for rate increases in the Direct Pay class.

VI.
FINDINGS OF FACT

1. Blue Cross presented the testimony of John Lynch, FSA, MAAA who testified as to how the requested rate increase was calculated and that, in his opinion, the request increase was necessary.

2. The Attorney General presented the testimony of Ms. Barbara Niehus, FSA, MAAA who testified as to the analysis she conducted and the fact that, in her opinion, no rate increase was necessary.

3. Notwithstanding the fact that both the hearing panel and Commissioner reduced the increase requested by Blue Cross last year, the increase granted last year resulted in greater earnings than anticipated.

4. The actual experience of the Direct Pay class last year was better than expected leaving 3.25% (before federal income tax) actually available for a contribution to reserves.

5. The Direct Pay class is in an unique position when compared to group business in that the majority of subscribers pay the full premium themselves without beneficial tax treatment.

6. Blue Cross has not accounted for the large influx in healthy lives that has been experienced in the last three years. This "Pool mix" should be taken into account to reduce the requested trend factors.

7. The trend used for pricing was approximately 10% in 2006 and 9% in 2007 but in both years the actual results were approximately 0%.

8. Based upon these facts Blue Cross' proposed contribution to reserves from Direct Pay rates is disallowed.

9. Based upon these facts the trend proposed by the Attorney General's actuary should be used to develop the Direct Pay rates.

10. Any Conclusion of Law that is also a Finding of Fact is adopted as a Finding of Fact.

VII.
CONCLUSIONS OF LAW

1. All Findings of Fact above are hereby incorporated into the Conclusions of Law.

2. The OHIC has jurisdiction in this mater pursuant to R.I. Gen. Laws §§ 27-18.5-1 *et seq.*, 27-19-6, 27-20-6, 42-14.5-3(d) and 42-14-5(d). The hearing was conducted in accordance with the provision of the Administrative Procedures Act, R.I. Gen. Laws § 42-35-1 *et seq.*

3. The OHIC has jurisdiction in this proceeding to conduct a hearing for purposes of considering whether or not Blue Cross' proposed rates for its Direct Pay products are consistent with the proper conduct of its business and in the interest of the public.

4. The "proper conduct" of Blue Cross' business requires Blue Cross to take steps to enhance the affordability of its products.

5. Blue Cross bears the burden of proving that the proposed rates are consistent with the proper conduct of its business and in the interest of the public.

6. The OHIC is authorized to disapprove the rates proposed by Blue Cross pursuant to R.I. Gen. Laws §§ 27-19-6 and 27-20-6.

7. Blue Cross has not met its burden of proof in this filing.

8. For all of the reasons set forth above, the rate increase requested by Blue Cross is hereby disapproved.

9. Any Finding of Fact with is also a Conclusion of Law is hereby adopted as a Conclusion of Law.

VIII.
RECOMMENDATION

Based on the above analysis, the hearing officer recommends that:

1. Consistent with the directives listed above, an increase in Direct Pay rates is not consistent with the proper conduct of the applicant's business and with the interest of the public.

2. The rates currently in effect for the Direct Pay class shall remain in effect until further order of the Commissioner.

Dated: February 12, 2009

Elizabeth Kelleher Dwyer, Esq.
Hearing Officer

ORDER AND DECISION

I, Christopher F. Koller, Health Insurance Commissioner of the State of Rhode Island, accept the recommendation of the Hearing Officer. The Hearing Officer's recommendation was based on two considerations: (1) should Direct Pay customers contribute to Blue Cross' reserves (Hearing Officer's Recommendation (hereinafter "Recommendation"), p. 14) and (2) whether Blue Cross' rates are based on trend factors that are too high (Recommendation, p.15).

As to the first issue, Blue Cross requested a contribution to reserves of 2.5%, comprised of a 2% for a contribution to reserves and .5% for taxes on that contribution (Blue Cross Exhibit (hereinafter "BC Ex.") 4, p. 52). Since the composite rate increase sought by Blue Cross was 5.9% (BC Ex. 1, p. 2), nearly half—approximately 42%—of Blue Cross' proposed composite rate increase this year was nothing more than a proposed contribution to its reserves. In other words, nearly half of the proposed rate increase was simply a sum of money that Direct Pay subscribers would pay every month to do nothing except increase Blue Cross' reserves. That sum of money would not cover higher medical costs or increased administrative expenses or greater utilization of health care services. It would only add to Blue Cross' reserve amounts, which stood at nearly $444 million as of September 30, 2008. (BC Ex. 4, p. 58) and is approximately 25% of SAPOR (surplus as a percentage of revenues). (Transcript Hearing, of Jan. 22, 2008 (hereinafter "Tr."), p. 81)

In last year's Direct Pay decision, the hearing panel rejected Blue Cross' request for a 1.25% contribution to its reserves. The panel's reasoning, quoted at length (including footnotes), was as follows:

> 36. In 2007, Blue Cross requested a 2% contribution to reserves, plus a .5% federal tax component.[42] The request for the reserves contribution was

rejected. The rationale for the rejection was discussed extensively in Pages 22-24 of Direct Pay 2007. The reasons included:

- The Direct Pay class was found to be particularly vulnerable to the high costs of health care (e.g., Direct Pay subscribers directly bear all the costs of health insurance and that it also contains a greater component of older, sicker participants (in Pool I) than employer groups, thereby driving up the class' medical claims costs);
- Direct Pay members should be afforded reasonable aid in their efforts to purchase affordable health insurance, including: (1) efforts by Blue Cross to keep health care cost increases low, (2) elimination of unnecessary administrative expenses, (3) investment of plan reserves in income-based subsidy programs and (4) in actuarial estimates that reflect a higher allocation of the risks to Blue Cross of the uncertainties inherent in the rate projection process;
- Blue Cross was expected to realize record-level net income for 2006 (expected $60 million in net income for 2006); and
- Blue Cross' reserves level was also at an all-time high, with expected earnings bringing it close to its minimum adequate reserves level.

37. Because Blue Cross' reserves level was nearly at the level determined to be adequate, a contribution to reserves by Direct Pay members was found "not in the consumer interest and it is not consistent with Blue Cross' mission as a publicly chartered, nonprofit charitable institution."[43]

38. Blue Cross' reserves are currently at 24% of SAPOR, or $425 million (based on 2007 premiums. This is net of the $20 million paid to the US Attorney.[44]

39. Because Blue Cross' reserves level is above the minimum level determined to be adequate, a contribution to reserves by Direct Pay members at this time is not in the consumer interest and it is not consistent with Blue Cross' mission as a publicly chartered, nonprofit charitable institution. The most vulnerable members of the Blue Cross community of insureds should not be asked to add to Blue Cross' reserves this year.[45]

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[42] 2007 Direct Pay Decision at 15.

[43] Consumers and the AG have suggested that no contribution to reserves be made because of the settlement with the US Attorney's Office. This is not a basis for our decision to deny a contribution to reserves in this Filing.

[44] Tr. II at 72-73.

[45] Blue Cross again argues that the Direct Pay reserves should viewed separately. This argument was thoroughly examined and rejected last year. See 2007 Direct Pay Decision at 23-24.

In re Blue Cross & Blue Shield of Rhode Island-Class DIR, OHIC 2008-01 (Feb. 15, 2008)

Blue Cross has not offered any evidence in this proceeding—and they bear the burden on the rates they seek—to suggest that the reasoning applied by the hearing panel last year on this issue is wrong (other than to say that they disagree with the Office (Tr., p. 36)) or that the factors that were applied last year were not present this year. The facts are the same and the reasoning still holds. Blue Cross has not shown that Direct Pay members no longer are vulnerable to the high costs of health care. Blue Cross has not shown that Direct Pay members should not be afforded reasonable aid in their efforts to purchase affordable health insurance. Blue Cross has not shown that its income for last year—especially on its Direct Pay line of business—was not adequate. In fact, Blue Cross actually made money on Direct Pay subscribers over the last two years—with contributions to reserves from Direct Pay subscribers of approximately $4.5 million (Tr., pp. 82, 170)—despite the fact that Blue Cross' Direct Pay rates were reduced significantly by this Office during that time period and Blue Cross was not afforded a contribution to reserves in its rates. Blue Cross has not shown that its reserves are below the minimum required by this Office. Reserves are greater than they were last year, both in total dollars and in SAPOR. Finally, Blue Cross's repeated calculation and citing of a cumulative negative Direct Pay-specific reserve figure (BC Ex. 4, p 57) as justification for additional reserve contributions has never been accepted by this Office. In short, Blue Cross has failed to meet its burden on the issue of whether it should be allowed to charge its subscribers a 2.5% so that it can add to its reserve level. Yet, what is most surprising is that Blue Cross actually increased its reserve component in this year's proposed rates

over last year's proposed rates. This is simply not acceptable. No conditions concerning the issue of Blue Cross' contribution to reserves have changed since last year, therefore there is no basis to alter the decision on reserves resulting from last year's Direct Pay hearing. This was the recommendation of the Hearing Officer (Recommendation, pp. 14-15) and I concur. For the reasons discussed above, as well as all those cited by the Hearing Officer, Blue Cross will not be allowed to increase its Direct Pay rates to contribute to its reserves.

The second potential category of premium increase identified by the Hearing Officer was the effect of recent shifts in enrollment on future premiums needed by Blue Cross for Direct Pay. The actuary for the Attorney General, Ms. Niehus, argued that Blue Cross had failed to account adequately in its rate projections for an increased proportion of Pool II ("healthy") enrollees in Direct Pay (a phenomenon known as "positive selection") and thus Blue Cross' requested premiums were too high (AG Ex. A, pp. 7-10, Tr. pp. 179-181). In turn, Blue Cross argued that in fact it had taken this into account, which was why its rate request was below the estimated inflation rate for the costs of medical care for its other lines of business (Tr., pp. 90-100).

Blue Cross's ongoing multi-product efforts at health insurance affordability are noted and should be continued, but their adequacy, efficacy and effect on premiums will not be assessed as part of this ruling.[1] The AccessBlue program is a significant and integral contribution to the affordability of the Direct Pay product in particular, and it is apparent that Blue Cross continues to make good faith efforts to improve it. Because Blue

[1] The Attorney General's concerns regarding oversight and public accountability for Blue Cross' Affordability Initiatives ((Post Hearing Memorandum of the Attorney General (hereinafter "AG Memo."), p. 24) are also noted.

Cross' affordability efforts—with the exception of AccessBlue—are not product-specific, they are better addressed in the context of larger lines of business (i.e., business in the small and large employer markets) where Blue Cross' efforts have a greater absolute effect and can be compared to and contrasted with the efforts of other insurers.

Instead, the difference in projected rates required for Direct Pay turns on a technical question: whether Blue Cross' adjustments for positive selection are adequate.

Ms. Niehus argues that Blue Cross does not adequately account for positive selection for the following reasons:

1. The credibility of such calculations by Blue Cross should be called into question, given its historical over-estimation of adequate premiums, resulting in significant positive contributions to reserves by the Direct Pay product in previous years, when the approved rates, according to Blue Cross, would have resulted in negative financial performance. (AG Memo., p. 15)
2. When trend factors are adjusted to reflect positive selection and the elimination of a contribution to reserve requirement, Blue Cross' own calculation methodology reflects sufficient premium at current rates to achieve necessary medical loss ratios. (AG Memo., p. 17)

Blue Cross argues:

1. Historical over-projections of expense for Direct Pay products are understandable, since all products were changed in 2006 and only now is there sufficient historical experience on which to base estimations ((Post Hearing Memorandum of Blue Cross (hereinafter "BC Memo."), p. 12).
2. Blue Cross's estimates already account for positive selection (BC Memo., p. 10).
3. The Attorney General's actuary revised estimates using a methodology that is flawed and over-counts projected revenue. (BC Memo., p. 11)

On this question, I find the arguments of Ms. Niehus to be persuasive. Ms. Niehus makes her case (that current premiums are sufficient if there is no reserve contribution and an appropriate Pool II to Pool I enrollment ratio is maintained to account for positive selection) by changing certain projections using Blue Cross's analytical model. Blue

Cross' refutation relies upon general assertions and does not recast Ms. Niehus' analysis to show where its putative inaccuracies lie.

It is entirely possible that Blue Cross may be correct in asserting that additional premium increases are needed for the Direct Pay product, however, based on the evidence presented at this hearing, I am not confident that this is the case. Furthermore, Blue Cross' projections have not been accurate over the past two years and previous efforts by this Office to adjust for those inaccuracies were insufficient. It is important to document the history of these rate filings:

Year beginning April 1	Avg. annual rate increase:		
	Requested	Granted	Needed
2007	7.8%	4%	2%[2]
2008	12.7%	8.7%	4.7[3]%

These figures show that Blue Cross has a history of conservatism in budgeting its rate needs for this product. Such caution is beneficial for the company but not for the Direct Pay enrollee. As this Office has noted before, if there is a risk to be borne in the rate setting process, that risk must be borne by the insurer, not the insureds, especially Direct Pay subscribers, who are particularly vulnerable to the costs of health insurance since

[2] This column is estimated by first determining Blue Cross' contributions to reserves as a percentage of premium for the 12-month period ending 3/31/08. That figure was approximately 2%. (AG Ex. F (Contribution to Reserve divided by Revenue for year ending 3/31/08)). The 2% is then subtracted from the percentage increase granted to Blue Cross for that period.

[3] This column is estimated by first determining Blue Cross' contributions to reserves as a percentage of premium for the partial year period 4/1/08 to 9/30/09. That figure is approximately 4%. (AG Ex. F (Contribution to Reserve divided by Revenue for the partial year period 4/1/08 to 9/30/09)). That 4% is extrapolated to the full year and is then subtracted from the percentage increase granted to Blue Cross for the year ending 3/31/09.

they alone pay the entire cost of health insurance in after-tax dollars.[4] And while there may be legitimate concern by Blue Cross about the challenge of "catching up" to an adequate premiums if this year's rates are not adequate, annual rate filings will provide Blue Cross sufficient opportunity to make adjustments as necessary in the future.

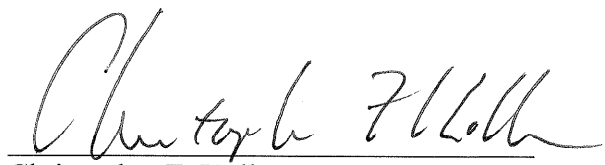
In sum, Blue Cross should not look to Direct Pay subscribers to add to its reserves and I am not convinced that Blue Cross sufficiently considered the increased enrollment of healthier Pool II subscribers when it projected the coming year's premiums. For these reasons, as well as all those cited by the Hearing Officer, Blue Cross will not be allowed to increase its rates.

It should be understood that this reprieve in price increases is due purely to disallowed contributions to reserves and enrollment characteristics, and it is temporary. Direct Pay subscribers will see their premiums go up in the future. While the current pricing appears to be adequate to cover Blue Cross' Direct Pay expenses for this year, Direct Pay is subject to the same cost pressures as all other health insurance programs. Health care expenses continue to rise at two to three times the rate of general inflation. Addressing that phenomenon remains the central challenge for all of us concerned with

[4] It is also important to note that rates that were too high over the last two years did not result in refunds to consumers, but instead resulted in additional contributions to Bleu Cross' reserves.

health care affordability and accessibility.

ENTERED AS AN ADMINISTRATIVE ORDER OF OFFICE OF THE HEALTH INSURANCE COMMISSIONER THIS 19th DAY OF FEBRUARY, 2009.



Christopher F. Koller
Health Insurance Commissioner

THIS DECISION CONSTITUTES A FINAL DECISION OF THE OFFICE OF THE HEALTH INSURANCE COMMISSIONER. AS SUCH, THIS DECISION MAY BE APPEALED TO THE SUPERIOR COURT SITTING IN AND FOR THE COUNTY OF PROVIDENCE WITHIN THIRTY (30) DAYS OF THE DATE OF THIS ORDER. SUCH APPEAL, IF TAKEN, MAY BE COMPLETED BY FILING A PETITION FOR REVIEW IN SAID COURT.